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## BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF  
LITCHFIELD PARK SERVICE COMPANY, AN  
ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE FAIR VALUE OF ITS  
UTILITY PLANTS AND PROPERTY AND FOR  
INCREASES IN ITS WASTEWATER RATES AND  
CHARGES BASED THEREON FOR UTILITY  
SERVICE.

DOCKET NO. SW-01428A-13-0042

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DOCKET NO. W-01427A-13-0043

## STAFF OPENING BRIEF

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files its opening brief in the above captioned matter. This brief addresses the disputed issues between Staff, the Residential Utility Consumers Office ("RUCO"), and the Liberty Utilities (Litchfield Park Water & Sewer) Corp. formally known as Litchfield Park Service Co. ("LPSCO" or Company") (together "Parties") and the issues resolved subsequent to pre-filed testimony. Staff maintains its position as presented in its pre-filed testimony on any issue not specifically addressed here.

**I. INTRODUCTION.**

LPSCO, is an Arizona public service corporation engaged in providing water and wastewater utility services in portions of Maricopa County, Arizona, pursuant to certificates of convenience and necessity granted by the Commission. LPSCO filed an application for a rate increase in the above captioned matter on February 28, 2013. During the Test Year, LPSCO served approximately 16,802

1 water and 16,161 sewer service connections'.<sup>1</sup> LPSCO is owned by Liberty Water, Inc., a wholly-  
2 owned subsidiary of Algonquin Power & Utilities Corporation ("APUC"), a publically-traded  
3 corporation on the Toronto Stock Exchange.

4 The Company's present rates and charges for utility service were approved by the  
5 Commission in Decision No. 72026 (December 10, 2010) using a test year ending September 30,  
6 2008. In its application for the water division, the Company requested a rate increase of \$2,257,160  
7 over its test year revenues of \$11,201,390. This would result in an increase of 20.15 percent for a  
8 total revenue requirement of \$ 13,458,550. The amount of increase would result in a 9.50 percent rate  
9 of return on its proposed \$35,647,602 fair value rate base ("FVRB") which is its original cost rate  
10 base ("OCRB").<sup>2</sup>

11 In its application for the wastewater division, the Company requested a rate increase of  
12 \$659,088 over its test year revenues of \$10,361,603. This would result in an increase of 6.36 percent  
13 for a total revenue requirement of \$11,020,691. The amount of increase would result in a 9.50 percent  
14 rate of return on its proposed \$23,877,697 FVRB which is its OCRB.<sup>3</sup>

15 Prior to the settlement agreement made by LPSCO and RUCO, Staff recommended water  
16 rates that produce a total operating revenue of \$12,276,127, an increase of \$1,074,737 or 9.59  
17 percent, over the adjusted test year revenue of \$11,201,390 to provide \$652,686 in operating income  
18 and an 8.10 percent return on the \$33,119,464 Staff-adjusted FVRB and OCRB.<sup>4</sup> Staff recommended  
19 wastewater rates that produce total operating revenue of \$10,303,654 a decrease of \$57,949 or 0.56  
20 percent, under the adjusted test year revenue of \$10,361,603 to provide \$1,897,396 in operating  
21 income and an 8.10 percent return on the \$23,424,640 Staff-adjusted FVRB and OCRB.<sup>56</sup>

22 On December 2, 2013, counsel for RUCO contacted counsel for LPSCO and Staff to raise the  
23 possibility of resolving the few remaining disputed issues prior to the start of the hearing.<sup>7</sup> From the  
24 December 2, through December 11, 2013, representatives from the parties discussed the issues that

25 <sup>1</sup> LPSCO Rate Application at 1.

26 <sup>2</sup> *Id.* at 3-4.

27 <sup>3</sup> *Id.*

28 <sup>4</sup> Carlson Direct, Ex. S-6 at 6.

<sup>5</sup> Carlson Direct, S-6.

<sup>6</sup> *Id.* at 7.

<sup>7</sup> Settlement agreement, Ex. A-17 at 1.

1 remained in dispute to work towards resolving those issues. As Staff witness, James Armstrong  
2 testified, Staff assisted in the drafting of rate design schedules but was not a party to all discussions.<sup>8</sup>  
3 Staff chose not to be a signatory to the Settlement Agreement.<sup>9</sup> As a result of those efforts, the three  
4 parties eliminated most of the issues in dispute. However, only LPSCO and RUCO entered into the  
5 settlement agreement ("Settlement Agreement").<sup>10</sup> While Staff chose not to be a signatory, Mr.  
6 Armstrong testified that Staff has no opposition to the Settlement Agreement.<sup>11</sup>

7 As a result of the settlement, the parties are now in material agreement on: the Company's fair  
8 value rate base; the level of operating expenses; the rate of return; the revenue requirement; and the  
9 rate design. The parties also agreed to a Declining Usage Adjustment ("DUA"), and a Purchase  
10 Power Adjustment Mechanism ("PPAM") as modified by Staff.<sup>12</sup> The only remaining issue is the  
11 adoption of a System Improvement Benefit mechanism ("SIB") and a Collection System  
12 Improvement Benefit ("CSIB") mechanism.<sup>13</sup>

13 Staff supports the Settlement Agreement because it strikes a balance between what is good for  
14 the customer and what is good for the Company. Staff believes the Settlement Agreement is in the  
15 public interest and urges the Commission to adopt it.<sup>14</sup>

## 16 **II. REVENUE REQUIREMENT, RATE BASE, AND COST OF CAPITAL.**

17 The Settlement Agreement for the water division adopts a 12.69 percent rate increase over  
18 adjusted test year revenues of \$11,201,268 for a total revenue requirement of \$12,622,779.<sup>15</sup> The  
19 water division settlement likewise adopts a total operating income of \$2,898,428 for an 8.76 percent  
20 rate of return on adjusted FVRB of \$33,103,506.<sup>16</sup> Under the terms of the Settlement Agreement, for  
21 the wastewater division adopts a 3.29 percent rate increase over adjusted test year revenues of  
22 \$10,362,796 for a total revenue requirement of \$10,704,021. The wastewater division of the  
23

24 <sup>8</sup> Armstrong Direct, Ex. S-1 at 1.

25 <sup>9</sup> Armstrong Direct, Ex. S-1 at 2.

26 <sup>10</sup> Settlement Agreement, Ex. A-17.

27 <sup>11</sup> *Id.* at 2

28 <sup>12</sup> Tr. Vol. I at 27.

<sup>13</sup> Tr. Vol., I at 24-25.

<sup>14</sup> Armstrong Direct, Ex. S-1 at 22; Tr. Vol. I at 45.

<sup>15</sup> Settlement Agreement, Ex. A-17 at Water Schedule A-1.

<sup>16</sup> *Id.*

1 settlement likewise adopts a total operating income of \$2,118,051 for an 8.76 percent rate of return on  
2 adjusted FVRB of \$24,190,673.<sup>17</sup>

3 The Settlement Agreement proposes a capital structure comprised of 15.87 percent long term  
4 debt and 84.13 percent common equity be adopted. Further it was agreed that RUCO's recommended  
5 return on common equity of 9.2 percent be adopted. The agreed upon cost of debt will be 6.4 percent  
6 along with a fair value rate of return of 8.76 percent.<sup>18</sup>

### 7 **III. RATE DESIGN AND BILL IMPACT.**

8 The rate design for the water division includes inverted tiers intended to promote water  
9 conservation. The Company's low income tariff reflects an increased discount from 15% to 30% for  
10 eligible customers.<sup>19</sup> LPSCO indicates the revised tariff will be filed as part of the final approved  
11 tariffs after a Commission Decision is approved.<sup>20</sup>

12 When the new rates take effect for the water division, the monthly bill for a ¾" residential  
13 water customer using 8,827 gallons per month will be \$26.87. This is a \$2.54 per month increase, or  
14 10.45 percent, over the previous rates.<sup>21</sup>

15 When the new rates for the wastewater division take effect the monthly bill for a residential  
16 wastewater customer will be \$40.35 per month. This is a \$1.36 per month increase, or 3.488 percent,  
17 over the previous rates.<sup>22</sup>

### 18 **IV. BEST MANAGEMENT PRACTICES ("BMP").**

19 LPSCO currently has five Best Management Practices ("BMP") in place. They have agreed  
20 to put an additional five in place that were recommended by Staff. The BMP's currently in place by  
21 the Company are: BMP 2.2 (Youth Conservation Education Program Tariff); BMP 3.8 (Water Waste  
22 Investigations and Information Tariff); BMP 4.1 (Leak Detection Program Tariff); BMP 4.2 (Meter  
23 Repair and/or Replacement Tariff); and BMP 5.8 (Landscape Watering Restrictions Tariff).<sup>23</sup>

25 <sup>17</sup> Settlement Agreement, Ex. A-17 at Wastewater Schedule A-1.

26 <sup>18</sup> *Id.* at 4.

27 <sup>19</sup> *Id.* at 3.

28 <sup>20</sup> *Id.*

<sup>21</sup> *Id.* at Water Schedule H-2.

<sup>22</sup> *Id.* at Wastewater Schedule H-2.

<sup>23</sup> Engineering Reports, Ex. A-21 at 13.

1 The additional five BMP's recommended by Staff are: BMP 1.2- Special Events/Programs  
2 and Community Presentations Tariff; BMP 3.2- Landscape Consultation (Residential and/or Non-  
3 residential) Tariff; BMP 3.6- Customer High Water Use Inquiry Resolution Tariff; BMP 3.7-  
4 Customer High Water Use Notification Tariff; and BMP 5.2- WATER SYSTEM TAMPERING  
5 TARIFF.<sup>24</sup> Staff recommends that LPSCO file the five BMP tariffs with Docket Control, as a  
6 compliance item in this docket, within 45 days of the effective date of the decision in this  
7 proceeding.<sup>25</sup>

8 **V. PURCHASE POWER ADJUSTOR MECHANISM ("PPAM").**

9 The PPAM is an adjustor mechanism that allows a utility to track fluctuations in its cost of  
10 power.<sup>26</sup> The adjustor mechanism allows the utility to bill its customers for costs of power above  
11 what was set in the rate case or credit its customers for costs below that set in the rate case. Staff  
12 recommended approval of the PPAM subject to two conditions. First, the Company will provide an  
13 annual report on purchased power. Second, based on that report Staff will calculate the annual  
14 increase or decrease, and provide a Recommended Opinion and Order for Commission approval  
15 within 30 days of the Company's annual report.<sup>27</sup>

16 **VI. DECLINING USAGE ADJUSTMENT ("DUA").**

17 The Company requested a declining usage adjustment of approximately 1/2 percentage  
18 decrease or a \$58,000 decrease in test year revenues, based on the declining usage-driven revenue  
19 erosion of its 3/4 inch and 1 inch residential customers. Staff recommended approval of a DUA,  
20 subject to the condition that the Company file an annual report that details not only the 3/4 inch and 1  
21 inch customer usage, but all customer usage.<sup>28</sup> Staff will review the annual filings and, if necessary,  
22 provide a report and recommendation of the Commission.<sup>29</sup>

23 ...

24 ...

25

26 <sup>24</sup> Hains Direct, Ex. S-2, Engineering Report at 13.

27 <sup>25</sup> *Id.*

28 <sup>26</sup> Carlson Direct, Ex. S-6 at 37.

29 <sup>27</sup> *Id.* at 38.

<sup>28</sup> Carlson Direct, Ex. S-6 at 32.

<sup>29</sup> *Id.* at 32.

1 **VIII. SYSTEM IMPROVEMENT BENEFIT ("SIB") & COLLECTION SYSTEM**  
2 **IMPROVEMENT BENEFIT ("CSIB").**

3 The Company is seeking a SIB and a CSIB mechanism as set forth in Decision No. 73938 and  
4 is requesting that the SIB/CSIB be governed by all of the conditions and requirements that are set  
5 forth in that Decision.<sup>30</sup> The Company has also agreed to codify the SIB and the CSIB, if authorized,  
6 in Plans of Administration ("POA") that would tailor them to the specifics of this case.<sup>31</sup> As set forth  
7 in LPSCO's late filed exhibits A-25 (Wastewater POA) and A-26 (Water POA), some of the key  
8 provisions of the SIB/CSIB mechanism are as follows:

- 9 • Approval of SIB/CSIB-Eligible Projects – All SIB/CSIB-eligible projects  
10 must be reviewed by Staff and approved by the Commission prior to being  
11 included in the SIB/CSIB surcharge. All of the projects must be completed  
12 and placed into service prior to being included in the SIB/CSIB surcharge.  
LPSCO must file a report with the Commission every six months  
summarizing the status of all SIB-eligible projects.<sup>32</sup>
- 13 • Costs Eligible for SIB/CSIB Recovery – Cost recovery under the SIB/CSIB  
14 mechanism is allowed for the pre-tax return on investment and depreciation  
15 expense associated with those projects, net of associated plant retirements.  
The rate of return, depreciation rates, gross revenue conversion factor and tax  
multiplier are to be the same as established in this case.<sup>33</sup>
- 16 • Efficiency Credit – The SIB/CSIB surcharge will include an efficiency credit  
17 equal to five percent of the SIB/CSIB revenue requirement.<sup>34</sup>
- 18 • Surcharge Cap – The amount that can be collected annually by each  
SIB/CSIB surcharge filing is limited to 5 percent of the revenue requirement  
established.<sup>35</sup>
- 19 • Timing of SIB/CSIB Surcharge Filing – The Company: may file up to five  
20 SIB/CSIB surcharge requests between rate case decisions; may make no  
21 more than one SIB/CSIB surcharge filing every 12 months; may not make an  
22 initial SIB/CSIB surcharge filing prior to 12 months following the effective  
23 date of a decision in this case; must make an annual SIB surcharge filing to  
true-up its surcharge collections; and, must file a new rate case application no  
24 later than June 30, 2019 with a test year ending no later than December 31,  
2018, at which time any SIB/CSIB surcharge then in effect would be  
reviewed for inclusion in base rates in that proceeding and the surcharge  
would be reset to zero.<sup>36</sup>

25 <sup>30</sup> Tr. Vol. II at 76.

26 <sup>31</sup> *Id.* at 87-88

27 <sup>32</sup> Plan of Administration, Ex. A-26 at 3-6.

28 <sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 6.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 3 - 6.

- 1       •     SIB Rate Design – The SIB surcharge will be a fixed monthly charge on  
2       customers' bills, with the surcharge and efficiency credit listed as separate  
3       line items. The surcharge will increase proportionately based on customer  
4       meter size.<sup>37</sup>
- 5       •     Commission Approval of SIB Surcharge – Each SIB surcharge must be  
6       approved by the Commission prior to implementation.<sup>38</sup>
- 7       •     Public Notice – At least 30 days prior to a SIB surcharge becoming effective,  
8       the Company is required to provide public notice to customers in the form of  
9       a bill insert or customer letter. The notice must include: the individual  
10      surcharge amount by meter size; the individual efficiency credit by meter  
11      size; the individual true-up surcharge/credit by meter size; and, a summary of  
12      the project included in the current surcharge filing, including a description of  
13      each project and its cost.<sup>39</sup>

14       In addition, the SIB/CSIB require that the Company file the following information with each  
15      SIB/CSIB adjustment: (1) the most current balance sheet at the time of the filing; (2) the most current  
16      income statement; (3) an earnings test schedule; (4) a rate review schedule (including the incremental  
17      and pro forma effects of the proposed increase; (5) a revenue requirement calculation; (6) a surcharge  
18      calculation; (7) an adjusted rate base schedule; (8) a construction work in progress ("CWIP") ledger  
19      (for each project showing accumulation of charges by month and paid vendor invoices); (9)  
20      calculation of the three factor formula; and, (10) a typical bill analysis under present and proposed  
21      rates.<sup>40</sup> The Company also should provide current bill determinants.

22       The SIB/CSIB also require that the Company perform an earnings test calculation for each  
23      initial filing and annual report filing to determine whether the actual rate of return reflected by the  
24      operating income for the affected system or division for the relevant 12-month period exceeded the  
25      most recently authorized fair value rate of return for the affected system or division, with the earnings  
26      test to be: based on the most recent available operating income, adjusted for any operating revenue  
27      and expense adjustments adopted in the most recent general rate case; and, based on the rate base  
28      adopted in the most recent general rate case, updated to recognized changes in plant, accumulated  
29      depreciation, Contributions In Aid of Construction ("CIAC"), Advances in Aid of Construction  
30      ("AIAC"), and accumulated deferred income taxes through the most recent available financial

37 Plan of Administration, Ex. A-26 at 9.

38 *Id.* at 9 - 10.

39 *Id.* at 10.

40 *Id.* at 4-5.

1 statement (quarterly or longer).<sup>41</sup> If the earning test calculation shows that the Company will not  
2 exceed its authorized rate of return with the SIB or the CSIB surcharge, the surcharges may go into  
3 effect once approved by the Commission. If the earnings test calculation shows that the Company  
4 will exceed its authorized rate of return with the implementation of any of the surcharges, the  
5 surcharges may not go into effect. However, if the earnings test calculation shows the Company will  
6 exceed its authorized rate of return with the implementation of the full surcharges, but a portion of the  
7 surcharges may be implemented without exceeding the authorized rate or return, then the surcharges  
8 may be authorized up to that amount once approved by the Commission.<sup>42</sup>

9 **A. The SIB & CSIB Comport with the Arizona Constitution.**

10 The SIB/CSIB that the Company is seeking fulfills and is consistent with all of the  
11 requirements of the Arizona Constitution. However, RUCO has questioned the constitutionality of  
12 the SIB in other proceedings.<sup>43</sup> In fact, RUCO has challenged Decision No. 74081 in the Court of  
13 Appeals.<sup>44</sup> As Staff has noted in the dockets where RUCO has challenged the SIB, the SIB is  
14 permissible under the Arizona Constitution. The SIB provides ample opportunity for the Commission  
15 to ascertain LPSCO's fair value rate base and, thereby, comply with the requirements of the Arizona  
16 Constitution.

17 As discussed above, the Company is required to provide updated financial information  
18 (including a balance sheet, income statement, earnings test schedule, rate review schedule, revenue  
19 requirement calculation, surcharge calculation, adjusted rate base schedule, etc.) as part of the filing  
20 package every time it seeks Commission authorization to enact a SIB/CSIB surcharge. This  
21 information will enable the Commission to update the fair value rate base finding and determine the  
22 impact of the revenues (with the addition of the proposed SIB/CSIB surcharge) on the Company's  
23 fair value rate of return. The SIB/CSIB surcharge cannot go into effect without a Commission order  
24 and, ultimately, the Commission may terminate the SIB/CSIB at any time.

25  
26 <sup>41</sup> Plan of Administration, Ex. A-26 at 7.

27 <sup>42</sup> *Id.*

28 <sup>43</sup> See Docket Nos. Arizona Water, W-01445A-11-0310; Valencia Water, W-01212A-12-0309; Arizona Water,  
W-01445A-12-0348.

<sup>44</sup> See *RUCO v. Ariz. Corp. Comm'n*, CA-CC 13-002



1 RUCO cannot convincingly claim that the SIB is *per se* inconsistent with the Constitution's  
2 fair value requirements because the proposed SIB/CSIB expressly requires the Company to provide  
3 updated rate base information. To argue that the proposed SIB/CSIB will not comply with the  
4 Constitution implies that the Commission will ignore this information and not use it "to aid it in the  
5 proper discharge of its duties . . . ." See Ariz. Const. art XV, § 14. It is not reasonable to assume that  
6 the Commission will not act in accordance with the Constitution as to its future rate setting; instead,  
7 the opposite should be presumed.

8 RUCO has argued, as it has in other cases where a SIB has been proposed before the  
9 Commission, that the Commission may not determine a Company's fair value rate base by relying on  
10 a recent fair value finding (from a recent rate case) as a starting point and then updating that finding  
11 with new information. However, the Commission has wide discretion to decide the method it uses to  
12 determine fair value. As our Supreme Court has recognized, "the commission in exercising its rate-  
13 making power of necessity has a range of legislative discretion . . . ." *Simms v. Round Valley Light &*  
14 *Power Co.*, 80 Ariz. 145, 154, 294 P.2d 378, 384 (1956). In addition, the Company will be providing  
15 updated information that will allow the Commission to make new fair value findings.

16 In the present case, the proposed SIB/CSIB would provide a means for the Commission to  
17 update the Company's fair value rate base and thereby implement a series of step increases. This  
18 ratemaking mechanism is designed to allow the Company to undertake its substantial replacement  
19 program without having to resort to a repeated series of rate cases. See *Arizona Corp. Comm'n v.*  
20 *Ariz. Pub. Serv. Co.*, 113 Ariz. 368, 371, 555 P.2d 326, 329 (1976), (noting that a "constant series of  
21 rate hearings" does not serve the public interest). General rate cases can be time consuming and  
22 costly, both for the Company and for ratepayers, who pay for the costs of the rate case in rates.

23 In *Arizona Community Action Assoc. v. Ariz. Corp. Comm'n*, 123 Ariz. 228, 599 P.2d 184  
24 (1979), the court upheld step rate increases based on subsequent additions to the company's plant.  
25 Specifically, the utility was granted a six percent rate increase in year 1; in years 2 and 3 the company  
26 was permitted to increase its rates by a maximum of five percent per year if certain conditions were  
27 met. For the step 2 increase, the utility was permitted to increase its rates by the lesser of five percent  
28 of gross operating revenues or a revenue deficiency,

1 calculated by first totaling (1) the amount of electric properties placed in service  
2 since the prior rate increase, (2) construction work in progress for the preceding  
3 calendar year for any plant for which construction work in progress had previously  
been included in rate base, and (3) construction work in progress during the  
preceding calendar year for plants scheduled to go into service within two years.

4 123 Ariz. at 229, 599 P.2d at 185 (emphasis added). The sum of these amounts was then to be  
5 multiplied by the rate of return on electric plant authorized by the Commission. The court upheld this  
6 portion of the Commission's order, stating,

7 The Commission stated in the decision under attack that it . . . would initiate  
8 innovative procedures in an attempt to deal promptly and equitably with increasingly  
9 complex regulatory matters. At the Step I hearing, the Commission fulfilled the  
constitutional requirements of art. 15, §§ 3, 14, which mandate a finding of the fair  
value of all property at the time of fixing a rate.

10 The court further indicated that it did not "find fault" with the Commission's efforts to avoid a  
11 "constant series of extended rate hearings . . ." 123 Ariz. at 231, 599 P.2d at 187. Finally, the court  
12 noted that the Commission's order in the rate case "resulted in a determination of fair value [,]" and  
13 that further adjustments between rate cases "were adequate to maintain a reasonable compliance with  
14 the constitutional requirements if used only for a limited period of time." *Id.* (emphasis added).  
15 While the step increase mechanism was ultimately set aside by the court, it is important to note that  
16 the court did not find fault with the step increases *per se*; instead, it found that the step increase was  
17 triggered solely on a percentage of return on common equity, which fell largely within the  
18 Company's control. For this reason, it could not be the "sole criterion" for triggering the step  
19 increase. *Community*, 123 Ariz. at 231, 599 P.2d at 187.

20 The instant SIB/CSIB, however, differs from the step increase mechanism in *Community*  
21 *Action* in that there isn't any "test" subject to control by the Company. In fact, there is no guarantee  
22 that the Commission will authorize each increase as it depends on whether it is determined that the  
23 Company is earning more than its authorized rate of return. Further, the Commission may suspend  
24 the SIB/CSIB.

25 The proposed SIB/CSIB has been developed in the context of a full rate case in which the  
26 Commission has determined the Company's fair value rate base and approved the specific plant  
27 projects to be included in the SIB/CSIB. The SIB/CSIB will be limited to projects that replace plant  
28 used to serve existing connections. The SIB/CSIB further provide for the retirement (removal from

1 rate base) of the plant that has been replaced. Therefore, the new plant will not generate a new  
2 revenue stream.

3 As noted earlier, the amount to be collected by each SIB/CSIB surcharge is capped at five  
4 percent of the revenue requirement that will be established in this case. These amounts are subject to  
5 true-up, either in the annual SIB/CSIB filings or in the Company's next full rate case. Finally, the  
6 Company will have to file a full rate case by June 30, 2019 with a test year ending December 31,  
7 2018. These features serve to ensure that the resulting rates will be just and reasonable and that the  
8 SIB will be used only for a limited period of time.

9 Moreover, each annual SIB/CSIB surcharge requires Commission approval in order to take  
10 effect. The Company is required to provide information with each SIB/CSIB filing that will allow the  
11 Commission to determine the impact of the new plant on the Company's fair value rate base and  
12 consider the resulting impact on the Company's rate of return. Arizona case law does not require  
13 more.

14 RUCO may continue to argue that the SIB/CSIB is an example of "single issue ratemaking"  
15 and that such an approach is prohibited by *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 578 P.2d  
16 612 (App. 1978). That case, however, focuses upon the requirements of Article XV, section 14 of the  
17 Arizona Constitution, which pertain to determining fair value rate base:

18 "We . . . hold that the Commission was without authority to increase the rate without  
19 any consideration of the overall impact of that rate increase upon the return of . . .  
20 [the utility], and without, as specifically required by our law, a determination of . . .  
[the utility's] rate base."<sup>45</sup>

21 However, Article XV, section 14 is silent as to "single issue ratemaking." Wherever that term  
22 may have originated, it is not contained in the Arizona Constitution.

23 The *Scates* court was careful to make it clear that a full rate case is not required for every  
24 increase in rates.<sup>46</sup> The court noted that "[t]here may well be exceptional situations in which the  
25 Commission may authorize partial rate increases without requiring" a full rate case. Therefore, the  
26  
27

28 <sup>45</sup> *Scates*, 118 Ariz. at 537, 578 P.2d at 618.

<sup>46</sup> *Id.*

1 case does not preclude the Commission from updating previous findings based upon new  
2 information.<sup>47</sup>

3 In recognition of the *Scates* decision, the proposed SIB/CSIB clearly requires the Company to  
4 submit such information. There is no reason to presume that the Commission will not appropriately  
5 consider this information when evaluating each SIB/CSIB surcharge filing. Even if the Commission  
6 were to fail to do so, the time for a challenge is after the Commission has acted. It is inappropriate to  
7 assume that the Commission will fail in its future constitutional duties, especially when the proposed  
8 SIB/CSIB mechanism contains all the required ratemaking elements.

9 **B. RUCO Has NOT Provided A Valid Justification For Rejecting the SIB/CSIB In**  
10 **This Case.**

11 RUCO provides four major reasons for opposing the adoption of the SIB. First, RUCO argues  
12 that the SIB allows for the recovery of routine plant improvements outside of a rate case that would  
13 normally be recovered in a general rate case.<sup>48</sup> The Company contends that this is not a relevant  
14 argument because the purpose of a SIB/CSIB is to promote rate gradualism by allowing for smaller  
15 increases in rates between rate cases.<sup>49</sup>

16 Second, RUCO asserts that the SIB/CSIB is one-sided and only works in the interest of the  
17 Company and its shareholders.<sup>50</sup> However, unlike the DSIC-like mechanisms RUCO uses for  
18 comparison purposes, the SIB incorporates an efficiency credit that reduces by five percent the  
19 amount that customers would otherwise pay for this plant if the Company simply sought to recover  
20 such costs in its next rate case. RUCO claims the efficiency credit is insignificant, but does not  
21 propose an alternative.

22 Third, RUCO contends that there are no federal or state mandates that require the recovery of  
23 routine plant investments through a surcharge.<sup>51</sup> RUCO appears to be claiming that there must be  
24 some sort of a state or federal mandate before a SIB/CSIB would be permitted. Although RUCO did  
25 not cite to any authority to support that claim, it appears they are simply trying to distinguish the

26 <sup>47</sup> *Scates*, 118 Ariz. 531, 578 P.2d 612 (App. 1978).

27 <sup>48</sup> Mease Direct, Ex. RUCO-1 at 42.

28 <sup>49</sup> Krygier Rebuttal, Ex. A-5 at 22.

<sup>50</sup> Mease Direct, Ex. RUCO-1 at 42.

<sup>51</sup> Mease Direct, Ex. RUCO-1 at 44.

1 SIB/CSIB from the Arsenic Cost Recovery Mechanism ("ACRM"), the latter of which they support.<sup>52</sup>  
2 Contrary to RUCO's assertion, there is no requirement of a federal or state mandate before the  
3 Commission can exercise its ratemaking authority to create the SIB/CSIB or the ACRM.

4 Finally, RUCO indicates that the Company has not proven they would be unable to ensure  
5 safe and reliable water service or achieve cost recovery without the SIB/CSIB.<sup>53</sup> It is RUCO's  
6 position that the Company should replace aging infrastructure as part of the Company's normal  
7 course of infrastructure improvements to ensure continued safety and reliability.<sup>54</sup> RUCO further  
8 claims that a surcharge is not necessary for the Company to meet this obligation, that the Company is  
9 not claiming the SIB/CSIB is necessary for it to meet this obligation or that the Company has not  
10 alleged that it is financially unable to do so.<sup>55</sup> RUCO is correct that the Company is not claiming it  
11 will not be able to meet its obligation to provide safe and reliable water service without the  
12 SIB/CSIB.<sup>56</sup> Further, LPSCO has provided an extensive engineering report detailing the condition of  
13 the plant that the Company is seeking to include in the SIB/CSIB.<sup>57</sup> The sole issue is the time of the  
14 replacement and, more specifically, when the Company would receive a return on the investments.

15 In addition to the four main reasons addressed above, RUCO also addresses its concerns with  
16 the efficiency credit.<sup>58</sup> RUCO asserts that the efficiency credit is insignificant compared to the  
17 amount the Company will be collecting through the SIB surcharge.<sup>59</sup> When asked what was  
18 appropriate Mr. Mease stated that initially RUCO believed the number should be closer to 15  
19 percent.<sup>60</sup> However, he was quick to follow that up by stating that they do not really know what the  
20 right number would be.<sup>61</sup> As part of its argument, RUCO seems to assert that a reason for not  
21 adopting a SIB is that the Company will have no incentive to control its costs with this type of  
22 mechanism in place. However, this argument erroneously assumes two things. First, that the

23  
24 <sup>52</sup> *Id.*

25 <sup>53</sup> *Id.* at 42.

26 <sup>54</sup> *Id.* at 45.

27 <sup>55</sup> *Id.* at 45.

28 <sup>56</sup> Kryger Rebuttal, Ex. A-5 at 23-24.

<sup>57</sup> Engineering Reports, Ex. A-20 and Ex. A-21.

<sup>58</sup> Mease Direct, Ex. RUCO-1 at 43.

<sup>59</sup> Tr. Vol. II at 209 - 211.

<sup>60</sup> *Id.* at 225.

<sup>61</sup> *Id.*

1 Company would be willing to haphazardly increase its expenses in lieu of earning its authorized rate  
2 of return. Second, that Staff, RUCO and ultimately the Commission would fail to address this issue  
3 in the follow up rate case required with the SIB.

4 Mr. Mease was asked what things he looks for when coming up with RUCO's recommended  
5 FVRB. His response was that he looks at: a company's plant, the additions and deletions from plant  
6 over a period of time, accumulated depreciation, CWIP accounts, AIAC, CIAC, deferred income tax  
7 account, and any deferred regulatory assets or liabilities, how financially distressed the company is,  
8 and the current age and condition of its infrastructure.<sup>62</sup> However Mr. Mease is quick to follow up  
9 that he cannot outline exactly what the circumstances would be for RUCO to approve a SIB/CSIB.<sup>63</sup>  
10 These are all the things that the POA requires to be done in order for a SIB/CSIB to be approved.  
11 The major crux of the issue is that RUCO simply feels there is not an adequate amount of time  
12 provided to review all of the information required to approve a SIB/CSIB.<sup>64</sup>

#### 13 **VIII. DIFFERENCES BETWEEN SIB AND THE CSIB.**

14 Functionally the CSIB and the SIB are identical. The only real variation occurs in the  
15 NARUC accounts. The NARUC accounts for waste water plants are different from water plants.<sup>65</sup>  
16 While the SIB and the CSIB are different types of systems, the process of administration for either  
17 would work in a substantially similar manner.<sup>66</sup>

18 ...

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20 ...

21 ...

22 ...

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25 ...

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26 <sup>62</sup> *Id* at 221, 227.

27 <sup>63</sup> *Id.* at 227.

<sup>64</sup> *Id.* at 224.

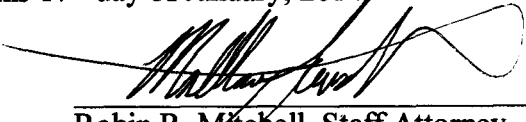
28 <sup>65</sup> *Id.* at 98.

<sup>66</sup> Tr. Vol. II at 98.

1 **IX. CONCLUSION.**

2 For the reasons discussed above, Staff recommends the Commission adopt the Settlement  
3 Agreement, and authorize the SIB and CSIB for LPSCO.

4 RESPECTFULLY SUBMITTED this 17<sup>th</sup> day of January, 2014.

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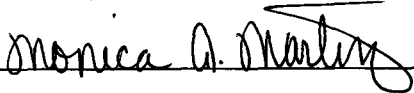
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